

**CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY (CHFFA)**

**BOND FINANCING PROGRAM**

**EXECUTIVE SUMMARY**

<b>Applicant:</b> Providence Health & Services ("Providence") Seattle, Washington (headquarters)	<b>Amount Requested:</b> \$350,000,000 <b>Date Requested:</b> Sept. 25, 2008 <b>Requested Loan Term:</b> 40 years <b>Resolution Number:</b> 335																				
<b>Obligated Group:</b> Providence Health & Services - Southern California <b>Project Sites:</b> Please see attached Exhibit 1 <b>Facility Types:</b> General acute/subacute and outpatient care																					
<b>Background:</b> Providence is a nonprofit organization whose mission is to serve the poor and vulnerable through compassionate service. Providence operates and provides health care services in the States of Washington, Oregon, Montana, Alaska and California.																					
<b>Use of Proceeds:</b> Bond proceeds will be used for the refunding of CHFFA Series 2001 A, B and C Bonds, CHFFA Series 1998 Bonds, and to refinance interim debt from US Bank.																					
<b>Type of Issue:</b> Negotiated public offering with fixed rate securities <b>Credit Enhancement:</b> None <b>Underlying Credit Rating:</b> Aa2/AA/AA Moody's/S&P/Fitch <b>Senior Underwriter:</b> Merrill Lynch & Co. <b>Bond Counsel:</b> Sidley Austin LLP																					
<b>Financial Overview:</b> Providence's income statement appears to exhibit solid operating results with positive net income over the review period, along with continued revenue growth. Providence's balance sheet also appears solid with a strong debt service coverage ratio and growing net assets.																					
<table><thead><tr><th colspan="2"><u>Estimated Sources of Funds (000's):</u></th><th colspan="2"><u>Estimated Uses of Funds (000's):</u></th></tr></thead><tbody><tr><td>Par amount of bonds</td><td>\$335,740</td><td>Refunding bonds</td><td>\$221,200</td></tr><tr><td>Original Issue Discount</td><td><u>14,260</u></td><td>Refinance interim debt</td><td>125,000</td></tr><tr><td></td><td></td><td>Financing costs</td><td><u>3,800</u></td></tr><tr><td>Total Sources</td><td><u>\$350,000</u></td><td>Total Uses</td><td><u>\$350,000</u></td></tr></tbody></table>		<u>Estimated Sources of Funds (000's):</u>		<u>Estimated Uses of Funds (000's):</u>		Par amount of bonds	\$335,740	Refunding bonds	\$221,200	Original Issue Discount	<u>14,260</u>	Refinance interim debt	125,000			Financing costs	<u>3,800</u>	Total Sources	<u>\$350,000</u>	Total Uses	<u>\$350,000</u>
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<b>Legal Review:</b> Staff has reviewed the applicant's responses to the questions contained in the Legal Status portion of the application. The information that was disclosed does not appear to question the financial viability or legal integrity of this applicant.																					
<b>Staff Recommendation:</b> Staff recommends the Authority approve a Resolution in an amount not to exceed \$350,000,000 for Providence Health & Services subject to a bond rating of at least an "A" category rating by a nationally recognized rating agency.																					

**STAFF SUMMARY AND RECOMMENDATION**

**Providence Health & Services**

September 25, 2008

Resolution Number: 335

**I. POLICY ISSUES:**

The Authority adopted bond issuance guidelines in September 2000 which includes a gross revenue pledge as a security provision and a minimum debt service coverage of 1.25x. The Authority acknowledged each financing must be reviewed individually and exceptions to these guidelines may be considered if the applicant demonstrates that such exception is a necessary part of a cost-effective and prudent borrowing strategy. Providence Health Systems management and bond counsel state that existing master indenture covenants which govern bond issuances through several different issuers would preclude Providence from instituting a gross revenue pledge. Additionally, in light of recent market tumult, Providence desires a minimum debt service coverage of 1.10x to afford Providence maximum flexibility in a potentially chaotic marketplace. In consideration of the historical and current financial strength of Providence (its current proforma debt service coverage is a healthy 9.27x) and the extraordinary market conditions over the last year, staff recommends the gross revenue pledge guideline be waived and the master indenture require a minimum debt service coverage of 1.10x.

**II. PURPOSE OF FINANCING:** Providence seeks to use approximately \$221.2 million in bond proceeds to refund long-term debt for projects in Southern California. The refunding bonds will be issued as fixed rate bonds, replacing auction rate bonds and will eliminate risk to Providence as well as provide liquidity to the bondholders. In addition, Providence plans to use approximately \$125 million in bonds proceeds to refinance interim financing provided by US Bank.

***Refunding of existing Authority debt..... \$221,200,000***

*CHFFA Series 2001 A, B, and C Bonds .....\$160,200,000*

CHFFA Series 2001 A, B and C insured auction rate bonds were used to remodel and purchase equipment for the following facilities: Providence Holy Cross Medical Center, Providence St. Joseph Medical Center, Little Company of Mary hospital, Little Company of Mary Pavilion, Little Company of Mary Sub-Acute Care Center and San Pedro Peninsula Hospital. The current auction interest rate on the bonds range from approximately 2.80% to 3.25%.

*CHFFA Series 1998 Bonds.....61,000,000*

CHFFA Series 1998 insured fixed rate revenue bonds were originally used to finance and refinance the acquisition, equipping, rehabilitation, and improvement of the following facilities: Little Company of Mary Health Services, Bay Harbor Hospital, Inc., Little Company of Mary Hospital, and San Pedro Peninsula Hospital. The current fixed rate on the bonds is approximately 5.0%. Nominal net present value savings, if any, are expected from the refunding. However, the refinancing of

this debt will eliminate the bond insurer and conform the bond covenants to the outstanding System's debt issued under the Providence Health & Services Master Trust Indenture.

***Refinancing US Bank Interim Loan..... 125,000,000***

Providence received variable rate interim financing from US Bank to finance the acquisition of the Tarzana Regional Medical Center. Providence Health & Services purchased the medical center from Tenet Healthcare Corporation. At the time of this report, the terms of the loan had not yet been finalized.

***Financing Costs .....3,800,000***

*Estimated issuance costs..... \$1,800,000*

*Underwriters discount .....2,000,000*

***Total Uses of Funds ..... \$350,000,000***

### III. FINANCIAL STATEMENTS AND ANALYSIS:

**Providence Health & Services**  
**Consolidated Income Statement of Operations (\$000's)**

	<b>For the year ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
<b><u>Operating Revenue</u></b>			
Net patient service revenue	\$ 5,092,729	\$ 4,637,229	\$ 4,340,077
Premium revenue	912,904	854,120	757,954
Other revenues	342,404	329,944	272,303
Total revenues	<u>6,348,037</u>	<u>5,821,293</u>	<u>5,370,334</u>
<b><u>Operating Expenses</u></b>			
Salaries and wages	2,413,085	2,232,082	2,048,921
Employee benefits	621,115	594,909	555,767
Purchased healthcare	539,351	492,461	412,241
Professional fees	186,276	169,355	147,116
Supplies	869,909	816,892	776,473
Depreciation	292,368	262,805	257,852
Interest and amortization	62,884	52,160	43,977
Bad debts	226,578	174,201	166,766
Provider tax	10,664	8,649	7,424
Purchased services and other	820,646	750,359	698,651
Total operating expenses	<u>6,042,876</u>	<u>5,553,873</u>	<u>5,115,188</u>
Excess of revenues over expenses	305,161	267,420	255,146
<b><u>Other Income</u></b>			
Net nonoperating gains, investment gains	349,421	189,723	105,798
Excess of revenues over expenses	<u>654,582</u>	<u>457,143</u>	<u>360,944</u>
Net assets released from restriction and other	21,566	18,540	15,237
Change in accrued additional minimum pension	25,925	52,493	(47,802)
Implementation of SF AS 158	(96,304)	-	(3,804)
Change in net unrealized gains (losses)	42,856	10,708	(31,454)
Reclassification of investment portfolio	(214,387)	-	-
Discontinued operations-Benefits Healthcare	-	(190,521)	13,954
	<u>(220,344)</u>	<u>(108,780)</u>	<u>(53,869)</u>
Increase in unrestricted net assets	<u>434,238</u>	<u>348,363</u>	<u>307,075</u>
Unrestricted net assets, beginning of year	4,012,733	3,664,370	3,357,295
Unrestricted net assets, end of year	<u>\$ 4,446,971</u>	<u>\$ 4,012,733</u>	<u>\$ 3,664,370</u>

**Providence Health & Services**  
**Consolidated Balance Sheets (in \$000's)**

	December 31,		
	2007	2006	2005
<b>Assets</b>			
Current assets:			
Cash and cash equivalents	\$ 359,390	\$ 410,937	\$ 349,883
Assets held under securities lending	257,001	159,169	-
Accounts receivable less allowance for bad debt	751,915	714,824	685,718
Premiums receivable	6,323	4,862	3,410
Other receivables, net	120,658	112,400	105,974
Supplies inventory	87,092	80,297	81,248
Other current assets	51,595	53,474	45,937
Current portion of assets whose use is limited	71,403	67,619	94,398
Total current assets	<u>1,705,377</u>	<u>1,603,582</u>	<u>1,366,568</u>
Assets whose use is limited:			
Board-designated cash and investments	2,189,463	2,115,003	2,000,759
Funds held for long-term purposes	7,660	27,572	27,267
Gift annuities and trusts	45,204	41,672	37,833
Funds held by trustee	346,299	322,731	200,723
Assets whose use is limited, net of current portion	<u>2,588,626</u>	<u>2,506,978</u>	<u>2,266,582</u>
Property, plant and equipment, net	3,289,435	2,929,823	2,608,325
Other assets	189,480	223,253	241,002
Total assets	<u>\$ 7,772,918</u>	<u>\$ 7,263,636</u>	<u>\$ 6,482,477</u>
<b>Liabilities &amp; Net Assets</b>			
Current liabilities:			
Current portion of long-term debt	\$ 33,240	\$ 36,769	\$ 47,889
Accounts payable	276,523	275,762	255,702
Accrued compensation	256,314	246,300	227,613
Payable to contractual agencies	79,977	91,756	105,916
Unearned premiums/deferred revenue	31,686	30,384	34,632
Liability for unpaid medical claims	41,511	42,153	48,087
Liability for risk-sharing	13,826	18,056	4,323
Liabilities under securities lending	257,001	159,169	-
Current portion of self-insurance liability	68,934	64,667	65,504
Other, including accrued interest	52,123	48,120	51,304
Total Current Liabilities	<u>1,111,135</u>	<u>1,013,136</u>	<u>840,970</u>
Long term debt, net of current portion	1,484,974	1,559,559	1,299,943
Other long-term liabilities:			
Self-insurance liability, net of current portion	194,478	187,719	167,274
Pension benefit obligation	225,956	171,111	189,532
Gift annuity obligations and trust	17,173	16,640	125,846
Other liabilities	66,644	89,593	-
Total other long-term Liabilities	<u>504,251</u>	<u>465,063</u>	<u>482,652</u>
Total liabilities	<u>3,100,360</u>	<u>3,037,758</u>	<u>2,623,565</u>
Net assets:			
Unrestricted	4,446,971	4,012,733	3,664,370
Temporarily restricted	170,957	162,460	143,145
Permanently restricted	54,630	50,685	51,397
Total Net Assets	<u>4,672,558</u>	<u>4,225,878</u>	<u>3,858,912</u>
Total Liabilities & Net Assets	<u>\$ 7,772,918</u>	<u>\$ 7,263,636</u>	<u>\$ 6,482,477</u>

**Financial Ratios:**

	Proforma (a)		
	FYE December 31, 2007		
Debt Service Coverage (x)	9.27	9.59	7.33
Debt/Unrestricted Net Assets (x)	0.34	0.34	0.40
Margin (%)		4.81	4.59
Current Ratio (x)		1.53	1.58

(a) Recalculates 2007 audited results to include the impact of this proposed financing.

## **Financial Discussion:**

**Providence's income statement appears to exhibit solid operating results with positive net income over the review period along with continued revenue growth.**

Providence's income statement appears to exhibit solid profitability over our review period with operating income remaining steady from \$255 million in fiscal year 2005 to \$305 million in fiscal year 2007. In addition, Providence appears to have shown solid operating margins of 4.75%, 4.59%, and 4.81% for fiscal years ending 2005, 2006 and 2007 respectively. Providence's revenues consist primarily of net patient service revenue accounting for approximately 80% of total revenues in fiscal year ending 2007. Total revenue increased from \$5.4 billion in fiscal year 2005 to \$6.3 billion in fiscal year 2007, an increase of 17%. Providence attributes the increase to focused efforts on eliminating waste through improved productivity, reduction in supply expenses, standardization of processing, and optimal use of shared administrative services.

**Providence's balance sheet also appears solid with a strong debt service coverage ratio and growing net assets.**

Providence's balance sheet appears to continue growing with total net assets increasing from \$3.8 billion in 2005 to \$4.7 billion in fiscal year 2007, an increase of nearly 24%. Providence attributes the increase primarily to the consolidation of the health care system formerly known as Providence Health System and the health care system formerly known as Providence Services. Cash and cash equivalent declined only slightly from approximately \$410 million in fiscal year 2006 to \$360 million in fiscal year 2007, despite the fact that Providence spent over \$722 million in capital expenditures. These capital expenditures include major capital expenditures for facility upgrades in all regions and new cancer centers in Alaska and Washington. Debt service coverage is a solid 9.59x and with the proposed financing will remain relatively unchanged at 9.27x, indicating that Providence can likely manage additional debt.

#### IV. BACKGROUND:

Providence Health & Services is a not-for-profit health system committed to providing a comprehensive array of services to meet the needs of communities across five states, including Alaska, Washington, Montana, Oregon and California. Providence continues the legacy of the Sisters of Providence and the Sisters of the Little Company of Mary in the West spanning more than 150 years.

Providence Health & Services includes 26 hospitals, more than 35 non-acute facilities, physician clinics, a health plan, a liberal arts university, a high school, approximately 45,000 employees and numerous other health, housing and educational services. The system office is located in Seattle, Washington.

Providence Health & Services in Alaska, Washington, Montana and Oregon is sponsored by the Sisters of Providence religious community. In Southern California, the health ministry is co-sponsored by the Sisters of Providence and the Little Company of Mary. Corporate Members of Providence Health & Services in Alaska, Washington, Montana and Oregon, with specified reserved canonical powers, are members of the Leadership Team of the Sisters of Providence, Mother Joseph Province. Corporate members of Providence Health System – Southern California are members of the Leadership Teams of both Sisters of Providence and Sisters of the Little Company of Mary.

**Licenses and Contracts:** Each of Providence’s California facilities is appropriately licensed by the Department of Health Services and is certified to participate in the Medicare and Medi-Cal programs.

#### V. UTILIZATION STATISTICS:

##### Providence Health & Services\*

<u>Facility Name</u>	<u>Location</u>	<u># of Acute Licensed Beds</u>	<u># of Licensed Long-Term Care Beds</u>
Providence St. Joseph Medical Center	Burbank	353	93
Providence Holy Cross Medical Center	Mission Hills	206	48
Little Company of Mary Hospital	Torrance	273	-
Providence St. Elizabeth Care Center	North Hollywood	-	52
Little Company of Mary Pavilion Torrance	Torrance	115	46
Little Company of Mary Sub-Acute Care Center	San Pedro	-	200
San Pedro Peninsula Hospital	San Pedro	183	0
Little Company of Mary Pavilion San Pedro	San Pedro	-	128
Little Company of Mary Recovery Center	San Pedro	-	48

\* California hospitals only.

**VI. OUTSTANDING DEBT:**

**Providence Health & Services**  
(000's)

<b><u>Bond Issue Name</u></b>	<b><u>Original Issue Amount</u></b>	<b><u>Amount Outstanding As of 12/31/07*</u></b>	<b><u>Estimated Amount Outstanding after Proposed Financing</u></b>
<i>Existing Debt</i>			
Series 1985, AIDEA Revenue Bonds	\$9,500	\$2,660	\$2,660
Series 1996 CHFFA Revenue Bonds	63,075	19,045	19,045
Series 1997, Direct Obligations Notes	32,640	13,710	13,710
Series 1998, CHFFA Revenue Bonds	75,000	60,640	0
Series 2001A, B & C, CHFFA Revenue Bonds	157,400	157,400	0
Series 2001A WHCFA Revenue Bonds	105,200	105,200	105,200
Series 2001B, WHCFA Revenue Bonds	51,400	14,475	14,475
Series 2003C, AIDEA Revenue Bonds	22,995	18,550	18,550
Series 2003H, AIDEA Revenue Bonds	36,000	36,000	36,000
Series 2003, HFACC Revenue Bonds	213,475	213,475	213,475
Series 2004, HFACC Revenue Bonds	100,000	98,700	98,700
Series 2005, Direct Obligation Notes	60,000	57,415	57,415
Series 2006A, WHCFA Revenue Bonds	212,165	210,555	210,555
Series 2006B, MFFA Revenue Bonds	68,430	68,430	68,430
Series 2006C, WHCFA Revenue Bonds	69,425	69,425	69,425
Series 2006D, WHCFA Revenue Bonds	69,275	69,275	69,275
Series 2006E, WHCFA Revenue Bonds	26,350	26,350	26,350
Series 2006F,	64,500	53,250	0

Direct Obligation Notes Series 2006G,	65,750	60,575	0
Direct Obligation Notes Series 2006H, AIDEA Revenue Bonds	54,355	54,355	54,355
Series 2006I, Direct Obligation Notes	53,600	53,600	0
Series 2008, Commercial Paper Notes**	200,000	200,000	170,000
		1,463,085	1,247,620
<i>Other debt</i>			
Premiums and discounts		7,676	7,676
Mortgages, leases, lines of Credit, and other		47,453	47,453
		55,129	55,129
<b><u>Proposed Authority Debt</u></b>			
Series 2008C, CHFFA Revenue Bonds		N/A	350,000
<b>Total Debt</b>		\$1,518,214	\$1,652,749

\*Includes current portion.

\*\*Closed on March 28,2008, subsequent to the FY 2007 audit.

## VII. DUE DILIGENCE:

Due diligence has been completed with regard to the following items:

- **Section 15438.5(a) of the Act (Savings Pass Through):** Providence properly completed and submitted the “Pass-Through Savings Certification,” in addition to a narrative explaining how it intends to pass through savings.
- **Section 15491.1 of the Act (Community Service Requirement):** Providence properly completed and submitted this certification and indicated that Medi-Cal and Medicare patients are accepted.
- **Compliance with Seismic Regulations:** Providence properly completed and submitted a description of its seismic requirements.
- **Compliance with Section 15455(b) of the Act (California Environmental Quality Act):** Providence properly submitted documentation to the Authority demonstrating the proposed project has either complied with Division 13 (commencing with Section 21000) of the Public Resources Code, or is otherwise not a project under that division.
- **Religious Due Diligence.**
- **Legal Review.**

## **EXHIBIT 1**

The following project sites are relevant to this transaction:

- Providence Saint Joseph Medical Center  
501 South Buena Vista Street, Burbank, California;
- Providence Holy Cross Medical Center  
15031 Rinaldi Street, Mission Hills, California;
- Little Company of Mary Hospital  
4101 Torrance Boulevard and 3531 Fashion Way, Torrance, California;
- Little Company of Mary Hospital Pavilion  
4320 Maricopa Street, Torrance, California;
- Little Company of Mary Sub-Acute Care Center  
3620 West Lomita Boulevard, Torrance, California;
- San Pedro Peninsula Hospital  
1300 West Seventh Street and 1322 West Sixth Street, San Pedro, California;
- Providence Tarzana Medical Center  
18321 Clark Street and 18365 Clark Street, Tarzana, California.